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MONTANA LOTTERY

FINANCIAL STATEMENTS
(Unaudited)

March 31, 2006

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MONTANA LOTTERY

FINANCIAL STATEMENTS
(Unaudited)

March 31, 2006

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APPOINTIVE OFFICIALS

George Parisot, Lottery Director

John Tarr, Lottery Assistant Director for Security

LOTTERY COMMISSION		TERM EXPIRES
Tom Keegan	Helena	January 1, 2010
Beth O'Halloran	Missoula	January 1, 2010
Robert Crippen	Butte	January 1, 2007
Wilbur Rehmann	Helena	January 1, 2009
Craig Anderson	Glendive	January 1, 2009

...section 2-7-202(3), MCA, copies of this report must be distributed to the following:

Governor – Brian Schweitzer
Director of Dept. of Administration – Janet Kelly
Legislative Auditor - Scott Seacat
President of the Senate – Jon Tester
Speaker of the House – Gary Matthews

The law also states "the President of the Senate and the Speaker of the House will determine the report distribution to each member of the appropriate committee of each house of the legislature". The President of the Senate and the Speaker of the House have requested that this report be distributed to the following committees:

HOUSE – State Administration Committee

Larry Jent, Chair
Dee Brown, Vice Chair Majority
Veronica Small-Eastman, Vice Chair Minority
Joan Andersen
Mary Caferro
Sue Dickenson
Emelie Eaton
Robin Hamilton
Gordon Hendrick
Teresa Henry
Hal Jacobson
William Jones
Gary MacLaren
Bruce Malcolm
Alan Olson
Bernie Olson

HOUSE – Business & Labor Committee

Jim Keane, Chair
Kathleen Galvin-Halcro, Vice Chair Majority
Joe McKenney, Vice Chair Minority
Elsie Arntzen
Bob Bergren
Tim Dowell
Kevin Furey
Dave Gallik
Ralph Heinert
Llew Jones
Mike Jopek
Harry Klock
Scott Mendenhall
Mike Milburn
Don Roberts
Wayne Stahl
Dan Villa
Jonathan Windy Boy

SENATE – State Administration Committee

Carolyn Squires, Chair
Joe Balyeat
Vicki Cocchiarella
Mike Cooney
Jon Ellingson
Jeff Essmann
Steve Gallus
Rick Laible
Dave Lewis
Jim Shockley
Joe Tropila

SENATE – Business & Labor Committee

Vicki Cocchiarella, Chair
Joe Balyeat
Duane Grimes
Dave Lewis
Glenn Roush
Frank Smith
Carolyn Squires
Donald Steinbeisser
Bill Tash
Jon Tester
Joe Tropila

Montana Lottery

June 2006

Montana Lottery Commission:

The Lottery will transfer $2,499,413 to the General Fund as a result of operations in the third quarter of fiscal year 2006 compared to $1,439,248 for the same time period last year. Total transfer to date will be $6,400,985 compared to $4,696,315 last year, a 36.3% increase and 79.9% of our total projected transfer for the year.

Scratch sales continue to be strong with a sales increase of 11.0% compared to the same time period last year. Powerball experienced another large jackpot run and sales for the year are 45.0% higher. All lotto games are experiencing some growth - Montana Cash 15.8%, Wild Card 3.8% and Hot Lotto 4.7%. Qwik Tix sales are down 19.2% but seem to have now leveled out. Overall sales are up 24% over last year at this time.

Direct game costs were consistent with sales for the quarter and the fiscal year, showing a 24.7% increase. Net operating revenue as a percent of total revenue is 31.8% for the quarter and 31.1% for the year to date. Total operating expenses of $1,095,255 for the quarter and $3,230,225 year to date are higher than last year's by 9.1%; total budgeted expenses are 77.1% of budget after three quarters of the year.

The conversion to Intralot went smoothly. While other state lotteries have experienced outages lasting many hours or several days during a vendor conversion, the system came up at 7 am on March 31st. We have experienced minor problems; but are correcting them as needed. Currently, we are in the process of customizing the system to fit the needs of the Lottery, as well as those of our retailers and players.

We have planned a full schedule of events for the summer to bring the Lottery directly to our players and to familiarize non-players with our games. We also plan to introduce exciting new scratch games over the next months.

Sincerely,

George Parisot
Director

2525 North Montana Avenue • Helena, MT 59601-0598
Phone 406-444-LUCK (5825) • Fax 406-444-5830

MONTANA LOTTERY
STATEMENT OF NET ASSETS
MARCH 31, 2006 and 2005
(UNAUDITED)

	Period Ended March 31, 2006	Period Ended March 31, 2005
ASSETS:		
CURRENT ASSETS		
Cash and Cash Equivalents	$ 3,055,511	$ 256,818
Receivables (Net)	1,107,870	1,293,480
Inventories	637,973	640,599
Other Current Assets	13,201	11,085
TOTAL CURRENT ASSETS	4,814,555	2,201,982
NONCURRENT ASSETS		
Computer, Furniture & Equipment	5,613,010	5,568,951
Accumulated Depreciation	(5,480,201)	(4,597,568)
Software, net of Amortization	0	164,286
Multi-State Receivable	1,351,649	1,291,000
TOTAL NONCURRENT ASSETS	1,484,458	2,426,669
TOTAL ASSETS	$ 6,299,013	$ 4,628,651
LIABILITIES:		
CURRENT LIABILITIES		
Accounts Payable	$ 383,335	$ 335,939
Estimated Prize Liability	1,771,465	1,356,979
Due to Primary Government	3,657	1,350
Transfer Obligations	2,499,413	1,439,248
Deferred Revenue	184,461	94,362
Current Portion Comp. Absences	129,147	79,311
Other Current Liabilities	0	6,500
TOTAL CURRENT LIABILITIES	4,971,478	3,313,689
NONCURRENT LIABILITIES		
MUSL Prize Liability	1,264,434	1,236,493
Accrued Compensated Absences	63,101	78,469
TOTAL NONCURRENT LIABILITIES	1,327,535	1,314,962
TOTAL LIABILITIES	6,299,013	4,628,651
NET ASSETS		
Unrestricted Net Assets	0	0
TOTAL LIABILITIES AND NET ASSETS	$ 6,299,013	$ 4,628,651

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
FOR THE QUARTERS ENDED MARCH 31, 2006 and 2005
(Unaudited)

	Quarter Ended March 31, 2006	Quarter Ended March 31, 2005	Nine Months Ended March 31, 2006	Nine Months Ended March 31, 2005
OPERATING REVENUES:				
Scratch ticket revenue	$ 2,885,650	$ 2,695,448	$ 8,669,389	$ 7,810,418
Powerball revenue	5,598,560	2,726,052	14,665,252	10,114,733
Montana Cash revenue	1,040,606	960,828	3,126,171	2,700,511
Wild Card revenue	629,705	567,233	1,755,203	1,690,560
Hot Lotto/Rolldown revenue	836,244	639,854	2,113,629	2,019,028
Qwik Tix revenue	91,787	108,995	276,302	342,084
License, permits, and misc	620	1,200	1,365	5,750
Total Operating Revenues	11,083,172	7,699,610	30,607,811	24,683,084
Less Direct Game Costs:				
Scratch ticket prize expense	(1,725,388)	(1,590,570)	(5,250,363)	(4,704,492)
On-line ticket prize expense	(4,072,874)	(2,408,878)	(10,786,964)	(8,288,497)
Retailer commission	(634,679)	(456,120)	(1,808,597)	(1,431,272)
Cost of tickets sold	(193,058)	(185,529)	(696,832)	(568,541)
Vendor fees	(927,862)	(636,047)	(2,562,224)	(2,067,587)
Net Operating Revenue	3,529,311	2,422,466	9,502,831	7,622,695
OPERATING EXPENSES:				
Advertising	136,934	105,015	398,046	305,317
Advertising Production	115,144	16,920	183,508	126,871
Audit Fees	19,505	2,725	61,602	18,756
Bad Debts Expense	0	3,659	(45)	3,167
Communications	23,194	26,356	65,518	67,781
Contractual Services	22,542	87,568	90,775	140,282
Depreciation and Amortization	247,646	267,274	783,576	801,891
Administrative Service Fee	13,486	13,580	40,457	40,739
State Cost Recovery	1,608	3,318	2,412	9,953
Multi-State Dues	0	0	72,333	88,856
Public Relations	4,344	2,549	12,987	9,175
Other	9,598	7,287	26,115	19,564
Personal Services	412,820	373,744	1,227,015	1,086,422
Repairs and Maintenance	4,573	6,121	8,774	15,228
Supplies and Materials	43,060	44,233	140,718	122,481
Travel	10,400	8,869	30,618	20,264
Utilities and Rent	30,401	28,520	85,816	82,859
Total Operating Expense	1,095,255	997,738	3,230,225	2,959,606
Operating Income	2,434,056	1,424,728	6,272,606	4,663,089
NONOPERATING REVENUES (EXPENSES)				
Interest earnings	65,357	14,520	128,379	34,951
Gain/Loss on sale of asset	0	0	0	(1,725)
Total Nonoperating Revenues(Expenses)	65,357	14,520	128,379	33,226
Income Before Operating Transfers	2,499,413	1,439,248	6,400,985	4,696,315
Operating Transfers In (Out) - General Fund	(2,499,413)	(1,439,248)	(6,400,985)	(4,696,315)
CHANGE IN NET ASSETS	0	0	0	0
Total Net Assets, Beginning of Period	0	0	0	0
TOTAL NET ASSETS, END OF PERIOD	0	$ 0	$ 0	$ 0

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN NET FUND ASSETS
AND RECONCILIATION OF BUDGET AND ACTUAL (BUDGETARY BASIS) TO GAAP BASIS
FOR THE NINE MONTHS ENDED MARCH 31, 2006
(Unaudited)

	Budget Fiscal Year July 1, 2005 - June 30, 2006	Actual Nine Months Ended March 31, 2006 (Unaudited)	Actual as a Percent of Final Budget (%)
REVENUES:			
Scratch ticket revenue	$ $10,500,000	$ 8,669,389	82.57
Powerball revenue	17,500,000	14,665,252	83.80
Montana Cash revenue	4,400,000	3,126,171	71.05
Wild Card revenue	2,300,000	1,755,203	76.31
Hot Lotto revenue	2,650,000	2,113,629	79.76
Qwik Tix revenue	500,000	276,302	55.26
License, permits, and miscellaneous	2,000	1,865	93.25
Total Revenues	37,852,000	30,607,811	80.86
DIRECT GAME COSTS:			
Prizes - Scratch ticket	6,195,000	5,250,363	84.75
Prizes - Lotto games	13,311,000	10,621,148	79.79
Prizes - Qwik Tix	300,000	165,816	55.27
Retailer commissions	2,222,500	1,808,597	81.38
Ticket cost - scratch games	735,000	696,832	94.81
Ticket cost - vendor fees	3,160,475	2,562,224	81.07
Total Direct Game Costs	25,923,975	21,104,980	81.41
OPERATING EXPENSES:			
Advertising	633,390	398,046	62.84
Advertising Production	111,200	183,508	165.03
Audit Fees	45,000	61,602	136.89
Communications	69,790	65,518	93.88
Contractual Services	177,834	90,775	51.04
Administrative Service Fee	53,281	40,457	75.93
State Cost Recovery	3,143	2,412	76.74
Multi-State Dues	102,975	72,333	70.24
Public Relations	34,124	12,987	38.06
Other	31,220	26,115	83.65
Personal Services	1,513,170	1,195,170	78.98
Repairs and Maintenance	22,055	8,774	39.78
Supplies and Materials	203,688	140,718	69.09
Travel	35,186	30,618	87.02
Utilities and Rent	112,600	85,816	76.21
Equipment	45,839	49,115	107.15
Total Operating Expenses	3,194,495	2,463,964	77.13
Operating Income	8,733,530	7,038,867	80.60
NONOPERATING REVENUES (EXPENSES):			
Interest Earnings	0	68,495	
Gain/(Loss) on Sale on Asset		0	
NET INCOME (BUDGETARY BASIS)	$ 8,733,530	$ 7,107,362	81.38
RECONCILIATION OF BUDGETARY/GAAP BASIS:			
1. Capitalized equipment purchases	45,839	49,115	107.15
2. Adjustment for compensated absences		(31,845)	
3. Adjustment for depreciation expense	(790,441)	(783,576)	99.13
4. Bad Debts		45	
5. MUSL interest earnings	20,000	59,884	299.42
Total Reconciling Items	(724,602)	(706,377)	
NET INCOME (GAAP BASIS)	$ 8,008,928	$ 6,400,985	79.92

The accompanying notes are an integral part of these financial statements.

ANALYSIS OF REVENUES AND EXPENSES BY PRODUCT
FOR THE NINE MONTHS ENDED MARCH 31, 2006
(UNAUDITED)

	SCRATCH	POWERBALL	MONTANA CASH	WILD CARD	HOT LOTTO	QWIK TIX	ADMIN
REVENUES:	$ 8,669,389	$ 14,665,252	$ 3,126,171	$ 1,755,203	$ 2,113,629	$ 276,302	$ 1,865
DIRECT GAME COSTS:							
Prize Expense	5,250,364	7,127,347	1,550,686	925,365	1,017,549	165,816	0
Retailer Commissions	711,151	733,679	156,356	87,798	105,719	13,393	0
Cost of Tickets Sold	696,832	0	0	0	0	0	0
Vendor Fees	721,962	1,230,855	262,180	147,229	177,196	22,803	0
NET OPERATING REVENUE	1,289,080	5,573,371	1,156,749	594,811	813,165	73,790	1,865
OPERATING EXPENSES:							
Advertising	77,977	231,679	28,424	28,424	28,424	1,436	1,682
Advertising Production	7,972	160,593	4,981	4,981	4,981	0	0
Audit Fees	0	0	0	0	0	0	61,602
Bad Debts	0	0	0	0	0	0	(45)
Communications	35,960	618	618	618	618	618	26,468
Contractual Services	1,700	8,995	498	498	498	755	77,832
Depreciation and Amortization	222,287	370,389	79,700	44,834	53,816	7,634	4,916
Administrative Service Fee	9,556	4,264	3,657	2,508	2,488	2,124	15,860
State Cost Recovery	0	0	0	0	0	0	2,412
Multi-State Dues	0	4,340	0	12,562	4,312	0	51,119
Public Relations	791	2,039	2,039	2,039	2,039	2,039	2,001
Other	384	2	2	2	2	21	25,702
Personal Services	415,415	136,655	107,012	65,342	64,570	55,720	382,299
Repairs and Maintenance	0	0	0	0	0	0	8,774
Supplies and Materials	30,756	4,332	4,382	4,292	4,292	3,638	89,027
Travel	513	168	168	168	168	0	29,433
Utilities and Rent	0	0	0	0	0	0	85,816
TOTAL OPERATING EXPENSES	803,311	924,074	231,481	166,268	166,208	73,985	864,898
OPERATING INCOME	485,769	4,649,297	925,268	428,543	646,957	(195)	(863,033)
NONOPERATING REVENUES (EXPENSES)							
Interest Earnings	0	0	0	0	0	0	128,379
Gain(Loss) on Sale of Asset							0
TOTAL NONOPERATING REVENUES (EXPENSES)	0	0	0	0	0	0	128,379
NET INCOME BY P	$ 485,769	$ 4,649,297	$ 925,268	$ 428,543	$ 646,957	(195)	$ (734,654)
PROFIT AS A % OF REVENUE	5.60%	31.70%	29.60%	24.42%	30.61%	-0.07%	N/A

NOTE: THIS IS ONLY THREE QUARTER'S ACTIVITY AND THEREFORE SHOULD NOT BE INTERPRETED TO SHOW HOW OUR PRODUCTS HAVE PERFORMED IN PAST YEARS OR WILL PERFORM IN THE FUTURE.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity.

The Montana Lottery, established under the provisions of Section 23-7-101, Montana Code Annotated (MCA), was approved by the Montana electorate through Legislative Referendum No. 100 on November 4, 1986.

Montana's first lottery tickets went on sale June 24, 1987.

The Montana Lottery is operated by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set the ticket price, number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games in conjunction with other lottery states and countries, and prepare financial reports. The Montana Lottery is attached to the Montana Department of Administration for administrative purposes.

The Montana Lottery is included as an enterprise fund in the State of Montana's Comprehensive Annual Financial Report. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Montana Lottery's financial statements as a reporting agency.

Basis of Presentation. The Montana Lottery reports its financial activity in accordance with generally accepted accounting principles (GAAP) as prescribed in pronouncements of the Governmental Accounting Standards Board (GASB).

Enterprise Fund. The Montana Lottery is classified as an Enterprise Fund of the Governmental Proprietary Fund Type. Enterprise Funds account for operations: a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate.

Basis of Accounting. The Montana Lottery's financial statements are prepared using the accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and become measurable; expenses are recognized in the period incurred, if measurable.

Revenue Recognition. Lottery scratch ticket sales are recorded as revenue based on the time the retailer activates the pack of tickets for sale. In accordance with an established policy, retailers may return unsold tickets to the Lottery for credit. Sales are decreased by an allowance for estimated ticket returns.

Ticket sales for lotto games, Powerball, Wild Card, Montana Cash, and Hot Lotto are recorded as revenue based on drawings. Tickets sold in advance for future drawings are recorded as deferred revenue until such time as the tickets become valid for the most current drawing. Qwik Tix revenue is recognized at the time of sale by the retailers.

Promotional Credits. The Lottery issues promotional credits to retailers to be used to distribute free tickets to players. The tickets are distributed as part of a promotion run by the retailer, e.g., "Ask for the Sale" or second chance drawings. The Lottery also directly distributes scratch tickets for promotional purposes at trade shows, for media give-aways, and during new game introductions. The tickets distributed as a result of promotional credits are reflected as a reduction in revenue. The related prize expense and ticket cost for all promotions are reclassified as an advertising expense. For the quarter ended March 31, 2006, promotional credits resulted in a revenue reduction of approximately $14,723 and an advertising expense reclassification of approximately $14,362. For the nine months ended March 31, 2006, promotional credits resulted in a revenue reduction of approximately $66,219 and a prize expense reclassification of approximately $52,408.

Prizes. Expenses for scratch prizes are recorded based on the predetermined prize structure for each game. Expenses for lotto and Qwik Tix prizes are recorded based on the predetermined prize structure for each individual game. No prize expense is recorded for free tickets distributed.

Unclaimed Prizes. Prizes for the lotto games must be claimed within six months after the appropriate draw date. Prizes for scratch games must be claimed within six months of the announced end of each game. Qwik Tix prizes must be claimed within six months of the sale date. The unclaimed prize amounts are taken as a reduction in the Lottery Prizes Payable liability and the Prize Expense and are transferred to the State of Montana General Fund as a portion of the quarterly transfer. The amount of unclaimed prizes for all games is represented in the table below.

	Quarter Ended 3/31/06	Quarter Ended 3/31/05	Year To Date 3/31/06	Year To Date 3/31/05
Lotto & Qwik Tix	$111,345	$144,281	$426,184	$393,634
Scratch	74,156	81,858	147,279	123,089
TOTALS	$185,501	$226,139	$573,463	$516,723

2. SUMMARY OF ACCOUNTS

Cash and Cash Equivalents. Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investment pool, cash on deposit with a bank and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily.

Cash and cash equivalents consist of the following:

	March 31,	
	2006	2005
Short-term investment pool	$2,897,424	$239,063
Cash on deposit with State Treasurer	147,937	7,605
Cash in revolving deposit account	10,000	10,000
Petty Cash	150	150
TOTALS	$3,055,511	$256,818

Reference to the State of Montana's Comprehensive Annual Financial Report would identify the level of risk associated with cash and cash equivalents in the short-term investment pool and amounts retained with the State Treasurer. The bank balance of the revolving deposit account was $11,752 at March 31, 2006 and was covered by federal depository insurance. The carrying amount reported in the balance sheet for cash and cash equivalents approximates the fair market value.

Receivables. Receivables include $1,193,238, representing amounts due the Lottery for tickets purchased by retailers. An allowance for doubtful accounts is reported as net of receivables and is based on historical perspective. As of March 31, 2006 the allowance is zero. An allowance for ticket returns is also included in the receivables amount. This allowance represents a reduction in receivables at March 31, 2006, for estimated ticket returns. This is an estimate based on returns received to date, as well as, an estimate of tickets unsold by retailers for games that have a public sale end date prior to April 1, 2006. The allowance for ticket returns is $93,089 at March 31, 2006. The return of vendor fees related to the allowance for returns is $7,721.

Inventories. Inventories consist of merchandise and supplies inventories. Merchandise inventory includes scratch tickets valued at $539,881 stored in the warehouse, at retailers prior to being activated by the retailer and with the marketing representatives. These ticket inventories are recorded at cost using the specific identification method and maintained on a perpetual inventory system. Tickets are charged to cost of tickets sold upon activation or after game end.

Supplies inventories include ticket dispensers, premiums and point-of-sale materials. At quarter end, supplies inventories totaled $98,092. These inventories are also recorded at cost using the specific identification method.

Other Current Assets. Other current assets consist of the following:

	March 31,	
	2006	2005
Prepaid Expenses	9,376	9,235
Employee Advances	3,825	1,850
TOTALS	$13,201	$11,085

Transfer Obligations. The account "Transfer Obligations" is $2,499,413 payable to the General Fund at March 31, 2006.

Compensated Absences. State employees earn vacation leave ranging from 15 to 24 days per year depending on the individual's years of service. Vacation leave may be accumulated not to exceed two times the maximum number of days earned annually. With no limit on accumulation, sick leave is earned at 12 days per year. Upon retirement or termination, an employee is paid 100% for unused vacation and 25% for unused sick leave. The Lottery's liability for compensated absences is detailed below.

Balance June 30, 2005	Net Leave Earned/(Used)	Balance March 31, 2006
$160,403	$31,845	$192,248

Commissions. Section 23-7-301(10), MCA, provides retailers a commission on scratch, Qwik Tix and lotto tickets or chances sold. The Lottery Commission established this commission at 5% of the face value of scratch tickets activated by the retailers and the face value of Qwik Tix and lotto tickets sold. In addition retailers can earn bonus commissions on tickets sold based on incremental sales of scratch tickets. For the quarter and nine months ended March 31, 2006 retailers earned bonus commissions of $79,720 and $274,778 respectively. For the quarter and nine months ended March 31, 2006 total commissions were $634,679 and $1,808,597 respectively.

3. MARKETING PRODUCTION EXPENSES

The Lottery has contracted with several vendors to provide marketing related services and materials. These services include media placement, creative design and layout, and media production. Those services and materials not included in the Advertising and Advertising Production expense categories are printing and ticket dispensers. The cost of these services and materials, included in Operating Expenses as Contracted Services and Supplies and Materials, are detailed below for the nine months ended March 31, 2006:

Printing	$22,885
Ticket Dispensers	21,399
	$44,284

4. PAYMENTS TO OTHER STATE AGENCIES

The Lottery receives a variety of services and supplies and materials from other state agencies. These services and materials are detailed below for the nine months ended March 31, 2006:

Insurance	$ 13,659
Warrant Writing Services	716
Payroll Services	788
Audit Fees	44,085
Computer Fees	20,282
Printing	1,564
State Accounting System Support	8,355
Supplies and Materials	5,613
Mail Processing Fees	5,720
Telecommunications	13,192
Vehicle Rental Fees	948
Administrative Service Fees	40,456
SWCAP and SFCAP	2,412
Other	4,056
TOTAL	$161,846

5. PRIZES

Paid Prizes. Section 23-7-402, MCA states, "A minimum of 45% of the money paid for tickets or chances must be paid as prize money". Prize expense is recorded based on the predetermined prize structure percentage for each game less unclaimed prizes. For the quarter ended March 31, 2006, the prize expense of $5,798,262 is 52.31% of net Lottery ticket revenue of $11,082,552. For the nine

months ended March 31, 2006, the prize expense of $16,037,327 is 52.39% of net Lottery ticket revenue of $30,605,946.

6. TRANSFER TO STATE GENERAL FUND

Section 23-7-402(3), MCA, states "That part of all gross revenue not used for payment of prizes, commissions, and operating expenses, together with the interest earned on the gross revenue while the gross revenue is in the enterprise fund, is net revenue. Net revenue must be transferred quarterly from the enterprise fund established by 23-7-401 to the State General Fund." For the quarter ended March 31, 2006, the net revenue payable to the State General Fund totaled $2,499,413.

7. MULTI-STATE LOTTERY JOINT VENTURE

In November 1989 the Montana State Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. Powerball, Wild Card, and Hot Lotto are the games jointly operated by the members, in which Montana presently participates. Each lottery participating in MUSL is represented on the Board of Directors.

The Multi-State Lottery Receivable with a balance of $1,351,649 as of March 31, 2006 is comprised of several reserve accounts, which are maintained by the Multi-State Lottery Association (MUSL). The balance of these reserve accounts is as follows:

Powerball Prize Reserve Account	$589,186
Powerball Unreserved Account	87,215
Powerball Set Prize Reserve Account	172,512
Wild Card Reserve Account	415,074
Hot Lotto Set Prize Reserve Account	87,662
TOTAL	$1,351,649

The Powerball Prize Reserve Account is to be used only in the event of an unanticipated prize claim. It is an insurance fund intended to protect the member lotteries against the liability that could result from a system failure at one of the member lotteries. All money paid to this fund would be returned to the Lottery one year after the Lottery leaves the Powerball game, assuming that no unanticipated prize claims have been paid. Interest earned on the Lottery's share of the fund, represented by the Unreserved Account, would be returned to the Lottery upon leaving MUSL. The amounts in the Unreserved Account may be used at the Board's discretion.

The Powerball Set Prize Reserve Account is used to fund prize payments for current drawings. Since the Powerball game has fixed prizes, it is often necessary to draw from this reserve to fund payment of prizes at the fixed amount. This account would be returned to the Lottery upon withdrawal from the Powerball Game.

The Lottery contributes to these reserve funds through the 50% set aside for prizes. In addition the Lottery was required to contribute for its portion of the reserve funds accumulated since the start of the Powerball game. The Lottery made this payment in full as of June 1990, through an additional 2% of drawing revenue rather than making a lump sum payment. Payments made to this fund are considered a portion of prize expense associated with the game.

The Wild Card Reserve Account is to be used in the event of an unanticipated prize claim on the Wild Card game. This account is also administered by MUSL and would be returned to the Lottery one year after the Wild Card Product Group of Idaho, Montana, South Dakota, and North Dakota is disbanded. The Lottery contributes to this account through the 55% set aside for prizes. Payments made to this fund are considered a portion of prize expense related to the Wild Card game.

The Hot Lotto Set Prize Reserve Account is administered by MUSL and is to be used only in the event of unanticipated prize claims. Like other MUSL games the reserve amount would be returned to the Lottery one year after withdrawal from the Hot Lotto game. The Lottery contributes to the reserve through the 50% set aside for prizes. Payments made to the reserve are considered a portion of the prize expense related to the game.

8. GAMES

Currently, the Montana Lottery games are scratch ticket games, four lotto games referred to as Powerball, Montana Ca$h, Wild Card, and Hot Lotto and four instant play/instant win games referred to as Qwik Tix.

Scratch ticket games provide players the opportunity to win instantly by scratching a latex covering to reveal a prize.

The Powerball game allows players the chance to win a minimum pari-mutuel jackpot of approximately $15 million. A player must match all 6 numbers to win the jackpot; players win prizes ranging from $3 to $200,000 for matching less than all 6 numbers. Drawings are held twice weekly on Wednesday and Saturday nights. For any drawing, if no ticket matches 6 out of 6 numbers, the jackpot rolls over to the next drawing to create a progressive jackpot. In March 2001, the Lottery added Power Play to the Powerball game. For an additional bet, the Power Play option provides non-jackpot winners the chance to multiply their prize amount by a factor of two through five.

The Montana Ca$h game allows players the chance to win a minimum pari-mutuel jackpot of $20,000. Players select 5 numbers from a field of 37 and must match at least 3 out of 5 to win a prize. Matching 3 of 5 wins $5 and 4 of 5 wins $200. The drawing is conducted twice weekly on Wednesday and Saturday nights. If no ticket matches all 5 numbers, the jackpot rolls over to the next drawing to create a progressive jackpot.

The Wild Card game allows players the chance to win a pari-mutuel jackpot, with a guaranteed minimum of $100,000. Players select 5 numbers from a field of 31 plus one of 16 face cards and must match all 5 numbers and the wild card to win the jackpot; players win prizes from $1 to $5,000 for matching less than all 5 numbers and/or the wild card. Drawings are held twice weekly on Wednesday and Saturday nights. If no ticket matches all 5 numbers and the wild card, the jackpot rolls over to the next drawing to create a progressive jackpot.

Hot Lotto allows players the chance to win a pari-mutuel jackpot with a guaranteed minimum of $1 million. Players choose 5 numbers from a field of 39 plus 1 Hot Ball number from a field of 19; the first 5 numbers and the Hot Ball must be matched to win the jackpot. Players can win prizes ranging from $2 to $10,000 by matching less than all 5 numbers and/or the Hot Ball. If no ticket wins the jackpot, it rolls over to the next drawing to create a progressive jackpot. Drawings are held twice weekly on Wednesday and Saturday nights.

Qwik Tix is a product line introduced by the Lottery in February 2004. There are four games, each with its own play style and prize structure. The four games are Lucky Numbers, a number match game; Hot Tac Toe, a tic tac toe grid; Jacks or Better, a poker game; and Montana Match, a match three symbols game. The Qwik Tix tickets are printed at the lotto terminal at the time of sale and can be redeemed immediately, with the maximum prize being $500. Each ticket costs $2 and consists of two plays of a single Qwik Tix game.

9. COMMITMENTS - GAMING SUPPLIER CONTRACTS

Scratch Tickets. On June 27, 2001 the Montana Lottery Commission approved the award of a one-year contract with Oberthur Gaming Technologies Corp. (Oberthur) for the provision of scratch tickets; the resulting contract was signed on August 8, 2001. The contract is for one year with the option for six additional one-year renewals. The contract contains specifications regarding ticket design, printing, game ownership, inspection, and prize structure.

Oberthur, as the vendor, provided a performance bond covering the contract term and an errors and omissions policy covering an ultimate net loss of $7,500,000. The Lottery may terminate this contract by providing proper notification to Oberthur.

On-line Services. On August 18, 1998, the Lottery signed a seven-year contract with Autotote Lottery Corporation to provide an on-line gaming system and associated services beginning March 28, 1999. The contract provides for payments to be made for the purchase of an on-line gaming system including terminals and software. The Lottery paid Autotote Lottery Corporation $5,025,311 for the system on April 26, 1999. Payment under the contract is also based on 8.35% of weekly Lottery sales. This contract expires on March 30, 2006.

On October 11, 2005, the Lottery signed a seven-year contract with Intralot, Inc. of Duluth, GA to provide an on-line gaming system and the associated services beginning March 31, 2006. The contract requires Intralot to provide new terminals to all retailers with the associated software and communications. Payment under the contract is based on 5.8% of net weekly Lottery sales. The contract provides for three one-year extensions, if agreeable by both parties.

10. CONTINGENT LIABILITIES - PRIZE ANNUITIES

During fiscal year 1989, the Montana Lottery awarded four Big Spin Jackpot prizes totaling $5,000,000. The Lottery made the initial payments to the winners in the amount of $253,088 and on September 26, 1988 the Montana Lottery awarded annuities in the amount of $2,350,180 to Western National Life. Through these annuities, Western National Life makes the remaining payments to the Big Spin Jackpot winners. As of March 31, 2006 the contingent liability for future prize payments funded through the purchase of annuities was $232,500.

11. LOTTO*AMERICA/POWERBALL/TRI-WEST JACKPOT PRIZES

Jackpot prizes awarded in the Lotto*America/POWERBALL and TRI-WEST LOTTO games are funded through the purchase of U.S. Treasury Zero-Coupon Bonds purchased in the name of the Montana Lottery by MUSL. MUSL will cash the bonds each year as they mature and will wire the funds to the Lottery for payment to winners on the Anniversary date of the win.

On January 13, 1990 the Montana Lottery awarded its first Lotto*America jackpot prize totaling $1,740,000. The first annual payment of $87,000 was made on February 1, 1990. On May 9, 1990 the Lottery awarded a second Lotto*America jackpot prize of $3,000,000. The first annual payment of $150,000 was made on May 23, 1990. A third jackpot prize was awarded on February 2, 1991 for $7,360,000. The first annual payment of $368,000 was made February 15, 1991. On November 23, 1991 a fourth jackpot prize was awarded totaling $46,967,738.57. The first annual payment of $2,355,738.57 was made December 12, 1991. On April 11, 1992 a fifth jackpot prize was won totaling $2,000,000. The first annual payment of $100,000 was made on April 27, 1992.

On July 6, 1994 the Montana Lottery awarded its first Tri-West Lotto jackpot prize totaling $700,565. The first annual payment of $35,000 was made on July 26, 1994.

On July 22, 1995 the Montana Lottery awarded its first Powerball jackpot prize totaling $31,401,655.99. The first payment of $1,571,655.99 was made on August 8, 1995. On April 5, 1997 the Lottery awarded a second Powerball jackpot prize totaling $11,000,000. The first annual payment of $550,000 was awarded on April 18, 1997.

As of March 31, 2006 the combined total of future prize payments funded through the purchase of U.S. Treasury Zero-Coupon Bonds for Lotto*America winners was $14,673,731. The combined total of future prize payments funded through the purchase of U.S. Treasury Zero-Coupon Bonds for Powerball and Tri-West Lotto winners was $20,460,210.

On March 27, 1999 the Montana Lottery had a Powerball jackpot winner. The prize was $35.1 million ($19.35 million cash option). The winner chose the cash option and was paid a lump sum in June 1999.

12. LEASES

Rent. The Montana Lottery leases its office, administrative and warehouse facilities under a noncancelable lease agreement that is effective March 2002 through February 2007. The monthly lease payments through February 2007 are $7,588.

13. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the State of Montana implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*. The Lottery participates in two investment pools: the Multi-State Lottery Association (MUSL) reserve accounts and the State of Montana's Short Term Investment Pool (STIP). There are four types of risk that must be disclosed. These risks are defined below, followed by their applicability to each of the investment pools.

Credit risk is defined as the risk that an issuer of an investment will not fulfill its obligation, i.e., not make timely principal and interest payments.

Custodial credit risk is the risk that the Lottery would not be able to recover the value of the investment or collateral securities that are in the possession of an outside party in the event of the failure of that party.

Concentration of credit is the risk of loss attributed to the magnitude of a government's investment in a single issuer.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

Multi-State Lottery Association The MUSL investment policy for prize reserve and unreserved funds states that permitted investments "include direct obligations of the United States government, perfected repurchase agreements, and obligations issued or guaranteed as to payment of principal and interest by agencies or instrumentalities of the United States government, and mutual funds of approved investments". Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk nor concentration of credit risk per GASB Statement No. 40.

The securities are held in trust for MUSL by Mellon Trust. This large diversified institution was chosen to minimize custodial risk. It has several national offices, with the Everett, Massachusetts office handling the MUSL account. Interest rate risk is minimized by requiring that the average portfolio maturity be no more than 1.33 years and that the maximum maturity for any one security cannot exceed five years.

Short-term Investment Pool All short-term funds are held in the State's Short Term Investment Pool (STIP) administered by the Board of Investments (BOI). A summarized description of their disclosure follows and full details may be obtained by contacting the Montana Board of Investments, 2401 Colonial Drive, PO Box 200126, Helena, MT 59620-0126.

For STIP securities, BOI's policy to manage credit risk requires securities have the highest investment grade rating in the short-term category by at least one Nationally Recognized Statistical Rating Organization (NRSRO). The six NRSROs include Standard and Poors, Moody's, Duff and Phelps, Fitch, IBCA and Thompson's Bank Watch.

Per the BOI, all STIP securities are registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank. The STIP investment policy does not specifically address concentration of credit risk. However, as of June 30, 2005 there were no single issuer investments that exceeded 5% of the STIP portfolio. Per GASB Statement No. 40, interest rate disclosures are not required for STIP since STIP is a 2a-7-like pool.